



OXFORD ANALYTICA

PERU

MONETARY TRANSPARENCY

Country Report 2005

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PERU



COMPLIANCE RATINGS

| <i>Monetary transparency</i> | 2005 | 2004 | 2003 | 2002 |
|------------------------------|-------------|-------------|-------------|-------------|
| Clarity of roles | •••• | •••• | •••• | •••• |
| Open decision process | •••• | •••• | •••• | •••• |
| Availability of information | ••••• | ••••• | •••• | •••• |
| Central bank accountability | •••• | •••• | •••• | •••• |
| Score | 4.25 | 4.25 | 4.00 | 4.00 |

OUTLOOK & COMMENTARY

The Central Reserve Bank of Peru (BCRP) has maintained high levels of transparency in its conduct of monetary policy and has continued to improve through increasing the comprehensiveness and detail of information on monetary policy made publicly available.

Concerns remain over certain institutional practices relating to the BCRP board, such as the concurrence of terms of BCRP directors and the executive, the ability of board members to hold parallel positions in, for example, the Ministry of Economy and Finance, and the failure to appoint a formal president of the board following the resignation of the previous board president. While these arrangements have not caused any problems in practise, from an institutional point of view they give cause for concern. All seven board members will be replaced following the election of a new government in 2006.

EXECUTIVE SUMMARY

4.25 Compliance in progress

The Central Reserve Bank of Peru (BCRP) has continued to maintain high standards of monetary policy transparency over the past year. There have been improvements in the information made available by the BCRP, and also in the level of detail of the information published. The BCRP continues to comply with the IMF Special Data Dissemination Standard (SDDS) in terms of coverage, periodicity and timeliness of data. Any changes to the monetary policy stance are explained, and data is continually updated through, for example, press releases, the *Weekly Report* and the *Inflation Report*.

The BCRP has continued to follow an inflation-targeting framework. Commentators noted that the BCRP has proved itself to be effective in conducting monetary policy, and transparent and professional in its workings. One area of concern flagged by commentators was the suggestion that the BCRP has increasingly been using foreign exchange operations, not only to moderate exchange rate volatility, but also to influence inflation. There was the suggestion that more information on this practise would increase transparency.

The fact that the Board of Directors' appointments coincide with those of the executive and Congress still raises concerns, even if this arrangement has not led to any problems in practise over the past couple of years. Attempts to put forward a reform proposal to change this arrangement came to nothing and they are unlikely to be re-visited in the foreseeable future. The president of the BCRP board has still not been replaced and is unlikely to be replaced until the next government. The post has been left to the acting president, Oscar Dancourt, who took over as BCRP vice-president in early November 2004. While this has not resulted in any problems in practise, the lack of concern about the absence of a formal president was regarded as worrying from an institutional point of view by some commentators.

A further area of concern relates to the fact that board members are allowed to hold positions in other government agencies whilst being a board member. There are some concerns that this might lead to a conflict of interests. The board member who in 2004 was at the same time the vice-minister of finance no longer holds that position, though two of the current board members also hold positions as presidents of other banks. This said, all directors holding external positions have to comply with the obligations and responsibilities established in Articles 20-21 of the LOBCR while exercising their duties as members of the BCRP board. As such, conflicts of interest arising from directors holding parallel positions are unlikely.

Addressing some of the concerns outlined above relating to formal procedures regarding the BCRP board would increase transparency, as would the publication of the minutes of board meetings, even if with a time lag.

Peru's overall score is unchanged from last year.

1. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES OF CENTRAL BANKS



Compliance in progress

The objectives and institutional framework of monetary policy

The 1993 Constitution of Peru clearly defines the objectives of the Central Reserve Bank of Peru (*Banco Central de Reserva del Peru* -- BCRP) and provides it with the necessary policy instruments to meet them.¹ It also establishes the independence of the BCRP from the different branches of the State.² This constitutional framework is elaborated further in the Organic Law of the BCRP (LOBCR).³

Central bank objectives and responsibilities

Both the constitution and the LOBCR establish that the sole objective of the BCRP is to maintain the stability of the Peruvian currency. The BCRP works under an inflation-targeting framework to attain its objective, using reference interest rates and daily liquidity interventions to influence the trend of inflation. The BCRP uses foreign exchange operations, if necessary, to moderate exchange rate volatility and, according to commentators, to control inflation.⁴ The BCRP is also responsible for endorsing the correct functioning of the financial markets, and conducting foreign exchange operations to maintain an adequate level of net international reserves.⁵ The BCRP is prohibited from introducing limits to foreign currency holdings or restrictions on international capital flows, as mandated by Article 64 of the constitution.

Operational autonomy

Article 84 of the constitution and Article 1 of the LOBCR provide for the complete financial and operational autonomy of the central bank. In July 2003, the BCRP President Richard Webb resigned owing to irreconcilable differences with other BCRP board members. Former Minister of Finance Javier Silva Ruete took over the presidency days later -- a situation that led to widespread speculation about likely political pressure from the government.

Some commentators had asserted that Webb's resignation appeared to have been caused by internal problems of administration and personnel promotions at the BCRP rather than overt political pressure. However, the fact that the Board of Directors' appointment coincides with that of the executive and Congress still raises concerns. There have been some attempts to put forward a reform proposal to change the process -- for example, to stagger each director's term or to appoint the board in the middle of the executive's tenure -- but nothing came of such proposals and they are unlikely to be re-visited in the foreseeable future.⁶

Institutional relationship between monetary and fiscal operations

Lending to government

The relationship between fiscal and monetary operations is clearly defined in the constitution and the LOBCR. In addition to the BCRP's institutional independence, both laws rule out any loans to the treasury or to state-owned enterprises, as well as prohibiting the issuance of guarantees. Article 61 of the LOBCR limits purchases of government bonds in the secondary bond market to 5% of the monetary base registered at the end of the previous fiscal year.

Central bank involvement in the rest of the economy

Article 84 of the LOBCR establishes that the BCRP may not buy shares, the only exceptions being those issued by international financial organisations, or those necessary for refinancing operations of private banking/financial institutions. Moreover, the BCRP cannot own (either directly or indirectly), capital of commercial, industrial or any other kind of enterprises. There have been no changes to the legal framework and the law has been fully observed during the past twelve months.

In addition, Article 62 of the LOBCR authorises the BCRP to perform open market operations with its own securities and with first-class securities issued by third parties. The BCRP website includes the text of the Procurement Law and displays adequate information about procurement operations.⁷

Central bank profit allocation

The BCRP determines profits for a given fiscal exercise on an annual basis. Article 92 of the LOBCR allocates 25% of its profits to the treasury, with the remaining 75% allocated to a reserve fund that may be used to cover future losses of the BCRP. Whenever the reserve fund cannot make up for the annual losses, Article 93 determines that the treasury will issue government bonds (equivalent to the remnant loss after the reserve fund) to finance the central bank. However, the law does not explicitly determine the maturity and debt servicing terms of these securities.

Agency roles performed by the central bank on behalf of the government

There have been no changes to laws and regulations concerning the agency roles performed by the BCRP on behalf of the government. These roles are clearly defined and transparently conducted. The BCRP is restricted to representing the government in international financial organisations and serving as a deposit agency for government foreign exchange reserves and the treasury account.⁸ Some commentators have said that the BCRP's role as fiscal agent and adviser to the government -- for example, during the formulation of the Multi-Annual Macroeconomic Framework (*Marco Macroeconomico Multianual* -- MMM) -- is perhaps too limited.⁹

2. OPEN PROCESS FOR FORMULATING AND REPORTING MONETARY POLICY DECISIONS

●●●● Compliance in progress

The framework, instruments and targets of monetary policy

Framework and monetary targets

In 2002 the BCRP introduced the changes required to adopt an inflation-targeting framework to fulfil its monetary policy objective. This framework has enhanced the effectiveness of BCRP liquidity interventions and has increased monetary policy transparency. The BCRP has consistently disseminated additional information on how its inflation targets are met, and how the monetary transmission mechanism works.¹⁰

Monetary instruments

The BCRP's chief statutory instrument is a reference short-term interest rate, which signals the intended trend of commercial banks' lending interest rates and inflation expectations. In order to implement changes in monetary policy via the reference rate, the BCRP sets credit regulations and overnight deposit requirements for commercial banks (in Peruvian soles and US dollars), and carries out open market operations with its securities to alter the level of the inter-bank interest rate.

In addition, the central bank is allowed to trade foreign exchange to reduce the exchange rate's short-term volatility. Although the BCRP is fully committed to keeping a floating exchange rate regime, commentators noted that, increasingly, the central bank has used foreign exchange transactions as a means to achieve price stability.¹¹ Some commentators stressed that because Peru is a highly dollarised economy and dollar inflows (from workers' remittances, exports, and portfolio investment) have been increasing, the BCRP has carried out substantial dollar purchases in the foreign exchange market and then issued bonds (short-term Certificates of Deposit) to reduce the liquidity of the domestic currency in the financial system. Indeed, given the time lag needed to change monetary conditions through interest rates and because the banking system has yet to develop broader financial services in the country, the financial sector takes the foreign exchange rate as the main signal to control short- to medium-term inflationary pressures.¹²

The monetary policy-making body

The Board of Directors of the BCRP is the monetary policy-making body. The authority of the board and its composition is set out in the constitution and the LOBCR. There have been no changes in the legal framework during the past twelve months concerning the allocation of monetary policy responsibilities.

Monetary board

The Board of Directors consists of seven members, four appointed by the executive and three by Congress. The executive chooses the president of the board, subject to congressional ratification. This appointment system has raised concerns about the BCRP's operational independence in practice. For example, in the first half of 2003 the board was caught in a damaging series of internal conflicts, with board members challenging the managerial and administrative style of then BCRP President Richard Webb (who resigned in July 2003). In November 2004, the

position again became open after the BCRP president, Javier Silva Ruete, took a position with the IMF. Commentators noted that the government had difficulties in selecting a candidate that would agree to take the position, and who would be ratified by Congress. Commentators also stated that the board was not keen to have a new president for the remainder of the current government given the smooth working of the board under current arrangements, and in the light of this knowledge the government did not push hard to find a president. The post has been left to the acting president, Oscar Dancourt, who took over as BCRP vice-president (and acting president) in November 2004.¹³ While this was not seen to be a problem in practise, and indeed the transparency, professionalism and effectiveness of the board was noted, the lack of concern about the absence of a formal president was regarded as worrying from an institutional point of view by some commentators.¹⁴ All seven board members will change with the election of a new government in April 2006, at which point a new president should also be appointed.

Commentators emphasised that these problems mostly stem from the fact that the tenure of board directors coincides with the executive and legislative terms. Although there are adequate restrictions on the ability to remove board members (which protect the independence of board directors), the fact that all the appointments match the political cycle can undermine the capabilities and independence of the position of the BCRP president. In this context, commentators have stated that it would be best for the term of board directors not to coincide with that of the executive president of Peru. As mentioned above, this proposal was initially discussed as part of a process of constitutional reforms, but it was soon discarded and it has become clear that there is no political resolve to start the process again.¹⁵ Moreover, some commentators argued that even if there are no doubts about the BCRP's independence to set monetary policy, potential board members have to be close to the Ministry of Finance in order to be appointed.¹⁶

Board members are allowed to hold positions in other government agencies and in other banks whilst being a board member. There are some concerns that this might lead to conflicting interests within the BCRP board. However, commentators said that given the relatively benign macroeconomic environment, addressing the coincidence of appointment terms should be the priority rather than the issue of parallel positions. Additionally, the board member who in 2004 was at the same time the vice-minister of finance, no longer holds that position.¹⁷ However two of the board members also currently hold positions as presidents of other state banks.¹⁸ This is legal and was not seen by commentators to be of concern given the integrity of the board members in question, though commentators noted that the ability to hold such parallel positions could, in theory, cause certain conflicts of interest for less professional board members.¹⁹ Central bank officials have stressed that all directors holding external positions have to comply with the obligations and responsibilities established in Articles 20-21 of the LOBCR while exercising their duties as members of the BCRP board. As such, conflicts of interest arising from directors holding parallel positions are unlikely.²⁰

Advance meeting schedule

Article 25 of the LOBCR mandates that board meetings must be held at least twice a month. An advance meeting schedule of sessions in which the board will approve the monthly monetary programme is made available in the first *Informative Note on the Monetary Programme* of each year.²¹ References to proceedings are available on the website, and monthly press releases inform society about the decisions that the board adopts.²²

Public statements on monetary policy

The *Inflation Report*, published three times each year, explains overall changes to the monetary programme. The *Informative Note*, released by the BCRP on the first Thursday of each month, details changes in monetary policy and monthly interest rates.²³ The daily press releases provide information on the average commercial inter-bank interest rate.²⁴

Periodic publications

In addition to the release of monetary policy statements, the BCRP publishes an *Annual Report* that includes an evaluation of monetary policy and BCRP targets during the previous year, the BCRP balance sheet and an overview of the monetary programme for the following year.²⁵ The BCRP also publishes a *Weekly Report*, with statistical tables of net international reserves, exchange rates and inflation, the trade balance, public sector accounts, external accounts, external debt, and monetary accounts.²⁶

Public hearings

The BCRP does not have an established policy of public consultation on technical changes. The BCRP website does not include any prior public consultation information, and authorities have not established readily available procedures to handle consultations. Nevertheless, BCRP directors and senior staff provide information through seminars and scheduled conferences aimed at raising public awareness about the BCRP and its functions.

Regulations on data reporting by financial institutions to the central bank

Article 74 of the LOBCR allows the BCRP to request information from commercial banks and other financial institutions, although a detailed list of which documents the BCRP can request is not explicitly incorporated in the law. Nevertheless, financial institutions submit their balance sheets on a weekly basis, along with information on foreign currency debts. Information requirements can be found on the BCRP website's *Circulares Vigentes* section.²⁷

3. PUBLIC AVAILABILITY OF INFORMATION ON MONETARY POLICY

●●●●● Full compliance

Release of central bank data

As part of its commitment to the IMF Special Data Dissemination Standard (SDDS), the BCRP continues to publish data that comply with SDDS coverage, periodicity, and timeliness requirements. The overall quality of the data is adequate, and coverage is extensive. The statistics are regularly updated and usually available both in English and Spanish. The BCRP publishes annual, quarterly, monthly, weekly and daily data on monetary aggregates, interest rates and reserves. The BCRP also releases a quarterly report on its income, expenses, and budgetary execution. There are advance release calendars for the main macroeconomic statistics and the *Weekly Report*.

The central bank balance sheet

The BCRP publishes on its website annual and monthly reports that include its balance sheet. Monthly reports have a lag of more than two months. In general, the BCRP uses a close approximation to International Accounting Standards (IAS) for its balance sheet; the *Annual Report* 2004 includes a note (which is part of the audited financial statements) that explains the main differences between the BCRP accounting practices and IAS.

Lender of last resort

Emergency lending rules are set out in Articles 58-59 of the LOBCR. The BCRP may perform lending operations to private financial institutions facing financial distress, when guaranteed with first-class securities and for periods of no more than 30 days. The BCRP may provide additional 30-day loans subject to the limits set out in Article 95, Section 2(c) of Law No. 27,102 which Modifies Several Articles of the Banking Law (the Banking Law is No. 26,702 -- *Ley General del Sistema Financiero y del Sistema de Seguros y Orgánica de la Superintendencia de Banca y Seguros*). The BCRP is forbidden to supply credits to the government or state-owned enterprises outside the scope of those provisions in Article 61 of the LOBCR. Lender of last resort operations are included in the *Annual Report*, and are disclosed in press notes if the BCRP board considers that the information will not disrupt financial stability.

Public information services

The BCRP has comprehensive information services, most of them available through its website. Information on monetary aggregates and foreign currency reserves is available on a daily and weekly basis. Fiscal and other macroeconomic data is released on a monthly and annual basis.

The central bank also makes available official publications and produces a journal of economic studies, although this is not published with a specified periodicity. The BCRP website contains presentations and speeches made by its senior officials. Specifically, the directors' notes on the monetary programme are also published on the website. Texts including the LOBCR, statutes, resolutions, memos, and legal norms are also available online. Nevertheless, commentators said that monetary policy transparency would be enhanced if the BCRP were to make publicly available the minutes and voting records of board meetings, even if with a time lag. The central bank does release a statement once a month on monetary policy decisions, which are taken by the board on the first Thursday of the

month. Over the past year there have been improvements in the detail in which significant monetary policy decisions are reported.²⁸

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

●●●● Compliance in progress

Accountability before a designated public authority

The BCRP is required to report to Congress on the conduct of monetary policy, policy objectives, and performance in achieving those objectives. Transparency practices include BCRP accountability regarding any deviation from monetary policy commitments. Its financial statements are subject to oversight by the Superintendence of Banking and Insurance (SBS). The central bank is also subject to external oversight by the Comptroller General.

Financial statement

Audited financial statement

The BCRP has its financial statements audited independently. For fiscal year 2004, Caipo y Asociados (a member of KPMG International) was selected as the external auditor; its report is available on the BCRP website.²⁹ Monthly and annual balance sheets and the BCRP financial statements are also available on the website.³⁰

External and internal audit

Article 87 of the LOBCR establishes that the Chief of the Internal Control Unit (ICU) is responsible for the ex-post control of the central bank's budget and net worth accounting. The ICU must report to the BCRP board and the Comptroller General (the office exercising external supervision) on all matters related to auditing the operations of funds and securities. Further, the ICU must submit a written report on the financial statements for the previous financial year to the BCRP board at their last meeting in March. Copies of this report are then sent to the Comptroller General and the SBS. After the approval from the central bank board, the ICU carries out an audit and certifies the accuracy of the annual balance sheet and the profit/loss statement, which are subsequently published. Commentators noted that there are no sanctions for the central bank not complying with its stated roles, responsibilities, and functions (though currently the central bank is doing so very well).³¹

Conduct of officials

The conduct standards for BCRP officials are outlined in Article 13 of the LOBCR. The law establishes that, before assuming office and within thirty days of leaving, all directors must make a sworn statement of their assets and income. The BCRP also publishes internal work regulations on its website.³²

Information on the legal protections for BCRP officials is publicly disclosed. Article 22 of the LOBCR stipulates that the filing of criminal charges against directors for acts performed or omissions incurred (while in office or subsequently) requires the enactment of impeachment proceedings for high officials, as set out in the constitution.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Peru between 19 and 21 October 2005:

Central Reserve Bank of Peru (BCRP)

19 October 2005

| | | |
|--------------------------|--------------------------------------|-----------------------------|
| Jorge Estrella Viladegut | Deputy Director of the Public Sector | Economic Studies Department |
| Fernando Herrada | | Economic Studies Department |

Ministry of Economy and Finance

21 October 2005

| | | |
|-----------------|--|-----------------------------|
| Javier Kapsoli | | Economic and Social Affairs |
| Briggit Bencich | | Economic and Social Affairs |

ADDITIONAL INTERVIEWS

19 October 2005

| | | |
|---------------|--|---|
| Eduardo Moron | Macroeconomics and Political Economy Area | Centro de Investigacion Universidad del Pacifico |
|---------------|--|---|

20 October 2005

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|------------|-----------------|--------------|
| Elmer Cuba | Chief Economist | Macroconsult |
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21 October 2005

| | | |
|------------------------------|---|--|
| Mario Alberto Guerrero Corzo | Senior Analyst, Economic Studies | Banco Wiese, Sudameris |
| Daniel Cordova Espinoza | Analyst, Economic Studies | Banco Wiese, Sudameris |
| Enrique Cornejo | Chief Adviser and National Director -- Economics | APRA Parliamentary Desk Partido Aprista Peruano |

NOTES

- ¹ Central Reserve Bank of Peru (Banco Central de la Reserva del Perú): www.bcrp.gob.pe.
- ² The 1993 Constitution of Peru, Title III of Economic Institutions: www.leyes.congreso.gob.pe
- ³ Organic Law of the Central Reserve Bank of Peru (LOBCR): www.bcrp.gob.pe/English/WLaw-Regulation/organic-law.htm
- ⁴ Interviews in Peru, 19-21 October 2005.
- ⁵ Title I, LOBCR: www.bcrp.gob.pe/English/WLaw-Regulation/organic-law.htm#TITLE_I
- ⁶ Interviews in Peru, 19-21 October 2005.
- ⁷ *Contrataciones y Adquisiciones* (in Spanish only): www.bcrp.gob.pe/Espanol/WLicitacion/Licitaciones.htm
- ⁸ Articles 61 and 70 of the LOBCR.
- ⁹ Interviews in Peru, 17-19 November 2004.
- ¹⁰ Interviews in Peru, 18-20 November 2003. A version of the core macroeconomic model for inflation forecasting was published in the BCRP Economic Research Journal (*Revista de Estudios Economicos*, in Spanish only), thus contributing to the dissemination of information on how the monetary transmission mechanism works. See www.bcrp.gob.pe/Espanol/WPublicaciones/Rev_Est_Econ.htm
- ¹¹ The exchange rate affects inflation more directly and significantly than interest rates, which are in practice a relatively weak instrument. Interviews in Peru, 19-21 October 2005.
- ¹² Interviews in Peru, 17-19 November 2004.
- ¹³ Interviews in Peru, 19-21 October 2005.
- ¹⁴ Interviews in Peru, 19-21 October 2005.
- ¹⁵ Changing this set up would require an amendment to the law governing the central bank. Some commentators noted that the central bank may be reluctant to open up the possibility of Congress proposing to change other aspects of the law. Interviews in Peru, 19-21 October 2005.
- ¹⁶ Interviews in Peru, 18-20 November 2003 and 17-19 November 2004.
- ¹⁷ Over the past year there was an attempt by Congress to forbid board members from holding parallel positions in the ministry of finance. Although some commentators suggested that the effort was politically motivated, the measure was not approved and is not likely to be proposed again. Interviews in Peru, 19-21 October 2005.
- ¹⁸ Kurt Burneo's position as president of the Banco de la Nación and Daniel Schodlowshy's position as President of Cofide (Corporación Financiero de Desarrollo) (a development bank). Interviews in Peru, 19-21 October 2005.
- ¹⁹ For example, they have access to privileged information such as the knowledge of when the central bank is going to change the interest rate, which is a potential problem, though so far there has not been any conflict of interest. Interviews in Peru, 19-21 October 2005.
- ²⁰ Interviews in Peru, 19-21 October 2005.
- ²¹ For the advance release calendar, see the *Informative Note on the Monetary Programme: January 2004* at: www.bcrp.gob.pe/English/WPolMon/Prog_Monetary.htm
- ²² See press releases at: www.bcrp.gob.pe/English/wpublicaciones/notas_prensa.htm
- ²³ These documents are available at: www.bcrp.gob.pe/English/WPolMon/Prog_Monetary.htm
- ²⁴ *Novedades* (in Spanish only): www.bcrp.gob.pe/Index.htm
- ²⁵ See *Annual Report 2003*: www.bcrp.gob.pe/English/WPublicaciones/memory2002.htm
- ²⁶ Weekly Reports: www.bcrp.gob.pe/English/WInformes/weekly_report_2001.htm
- ²⁷ 'Information requirements and penalties', Circular 04-2002-EF/90 (08/02/2002) -- (*Procedimiento para solicitar informacion estadistica y regimen de multas por incumplimiento*, in Spanish only): www.bcrp.gob.pe/Espanol/normas_legales/Circulares/c-2001/c082001.pdf
- ²⁸ Interviews in Peru, 18-20 November 2003 and 19-21 October 2005.
- ²⁹ *Dictamen de los Auditores Independientes* (in Spanish only): www.bcrp.gob.pe/Espanol/Wcontabilidad/Com_Est_Fin.htm
- ³⁰ www.bcrp.gob.pe/Espanol/Wcontabilidad/Balancegen.htm
- ³¹ Interviews in Peru, 19-21 October 2005.
- ³² For example, see the Guidelines for Institutional Representatives, Confidentiality and Conflicts of Interest (*Reglamento sobre Representacion Institucional, Confidencialidad y Conflicto de Intereses*, in Spanish only): www.bcrp.gob.pe/Espanol/normas_legales/Reglamento_Confid/RConfidencialidad.htm